Prepared by the Legislative Analyst's Office

This section provides an overview of the state's current bond debt. It also discusses the impact that the bond measures on this ballot would, if approved, have on this bond debt level and the costs of paying it off over time.

Background

What Is Bond Financing? Bond financing is a type of long-term borrowing that the state uses to raise money for various purposes. The state obtains this money by selling bonds to investors. In exchange, it agrees to repay this money, with interest, according to a specified schedule.

Why Are Bonds Used? The state has traditionally used bonds to finance major capital outlay projects such as roads, educational facilities, prisons, parks, water projects, and office buildings. This is done mainly because these facilities provide services over many years, their large dollar costs can be difficult to pay for all at once, and different taxpayers over time benefit from the facilities. Recently, however, the state has also used bond financing to help close major shortfalls in its General Fund budget.

What Types of Bonds Does the State Sell? The state sells three major types of bonds. These are:

- ***General Fund-Supported Bonds.*** These are paid off from the state's General Fund, which is largely supported by tax revenues. These bonds take two forms. The majority are *general obligation* bonds. These must be approved by the voters and their repayment is guaranteed by the state's general taxing power. The second type is *lease-revenue* bonds. These are paid off from lease payments (primarily financed from the General Fund) by state agencies using the facilities they finance. These bonds do not require voter approval and are not guaranteed. As a result, they have somewhat higher interest costs than general obligation bonds.
- ***Traditional Revenue Bonds.*** These also finance capital projects but are not supported by the General Fund. Rather, they are paid off from a designated revenue stream—usually generated by the projects they finance—such as bridge tolls. These bonds also do not require voter approval.
- ***Budget-Related Bonds.*** In March 2004, the voters authorized $15 billion in bonds to pay off the state's accumulated budget deficit and other obligations. Of this amount, $11.3 billion was raised through bond sales in May and June of 2004. This leaves $3.7 billion available for later sales. The General Fund cost of repaying the principal and interest on these bonds is the equivalent of one-quarter-cent share of the state sales tax (over $1.2 billion in 2004–05). The bonds' repayments are also guaranteed by the state's general taxing power in the event the sales tax proceeds fall short.

What Are the Direct Costs of Bond Financing? The state's cost for using bonds depends primarily on their interest rates and the time period over which they are repaid. For example, most recently sold general obligation bonds will be paid off over a 30-year period. Assuming tax-exempt interest rates for such bonds of about 5.25 percent, the cost of paying them off over 30 years is about $2 for each dollar borrowed—$1 for the amount borrowed and $1 for interest. This cost, however, is spread over the entire 30-year period, so the cost after adjusting for inflation is considerably less—about $1.25 for each $1 borrowed.

The State's Current Debt Situation

Amount of General Fund Debt. As of June 1, 2004, the state had about $40 billion of traditional General Fund bond debt outstanding on which it is making principal and interest payments. This consists of about $33 billion of general obligation bonds and $7 billion of lease-revenue bonds. In addition, the state has not yet sold about $30 billion of authorized general obligation bonds, either because the projects involved have not yet been started or those in progress have not yet reached their major construction phase. The above totals do not include the $15 billion of deficit-related bonds authorized in March 2004, of which $11.3 billion had been sold through June 30, 2004.

General Fund Debt Payments. We estimate that General Fund debt payments for traditional general obligation and lease-revenue bonds will be about $3.5 billion in 2004–05. As previously authorized but currently unsold bonds are marketed, outstanding bond debt costs would rise to approximately $5.8 billion in 2009–10, and slowly decline thereafter if no new bonds are authorized. If the annual costs of the deficit-related bonds are included, total debt-service costs will be $4.8 billion in 2004–05, rising to a peak of $7.4 billion in 2009–10.

Debt-Service Ratio. The level of General Fund debt payments stated as a percentage of state revenues is referred to as the state's debt-service ratio. This ratio is used by policymakers and the investment community as one indicator of the state's debt burden. This ratio increased in the early 1990s and peaked at slightly over 5 percent in the middle of the decade. The ratio currently stands at about 4.6 percent, and is expected to increase to a peak of 5.9 percent in 2008–09 as currently authorized bonds are sold. If the annual debt service on the deficit-related bonds is included, the ratio is currently about 6.2 percent, and will increase to a peak of 7.5 percent in 2008–09 before declining in subsequent years.

Effects of Bond Propositions on This Ballot

There are two bond measures on this ballot:

- Proposition 61, which would authorize the state to issue $750 million of general obligation bonds to finance various children's hospital facilities.
- Proposition 71, which would authorize the state to issue $3 billion of general obligation bonds for stem cell research.

The impacts of these measures on the state's debt situation are discussed below.

Impacts on Debt Payments. If the $3.75 billion in bonds on this ballot are approved and eventually sold, there would be additional debt-service payments averaging about $250 million annually over the life of the bonds. The annual debt-service payments, however, would be more modest in the near term, probably less than $50 million through 2009–10. This is primarily because provisions of Proposition 71 require that principal payments be deferred and interest costs be paid from the stem cell-related bond proceeds for the first five years after the measure takes effect. The lower payments in this initial five-year period would be offset by payments that are slightly higher than the $250 million average in the subsequent years, as the deferred principal payments come due.

Impacts on the Debt-Service Ratio. Because of the deferred debt-service payments provided for in Proposition 71, only sales related to Proposition 61 hospital bonds would have an impact on General Fund debt-service payments during the next five years. Thus, approval of the bonds on this ballot would have only modest impacts on the debt-service ratio through 2009–10—less than 0.1 percent. Thereafter, the sale of the bonds would result in annual increases in the debt-service ratio of roughly 0.3 percent per year.